IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF KANSAS

In Re:	
DENNIS L. IRELAND,	Case No. 02-41661 Chapter 7
Debtor.	Chapter /
MICHEAL A. IRELAND,	
Plaintiff,	
vs.	Adversary No. 02-7101
DENNIS L. IRELAND,	
Defendant.	

MEMORANDUM AND ORDER

This matter is under advisement after trial of Micheal Ireland's Complaint to Determine Dischargeability of Debt owed by Debtor, Dennis Ireland, pursuant to 11 U.S.C. § 523(a)(2)(A), or alternatively, to deny him a discharge under 11 U.S.C. § 727(a)(4).¹ The Court has judged the credibility of the witnesses and made an independent review of applicable law. For the reasons discussed below, this Court finds that Plaintiff Micheal Ireland has demonstrated by a preponderance of the evidence that a \$5,000 debt should be excepted from discharge under § 523(a)(2)(A). The Court further finds Micheal Ireland has failed to sustain his burden of proof seeking to deny the entire discharge under § 727(a)(4)(A), and his complaint is dismissed with prejudice with respect to that second cause of action. The Court's findings of fact and conclusions of law follow.

All future statutory references are to the Bankruptcy Code, 11 U.S.C. § 101, et seq., unless otherwise specified.

¹All future statutory references are to the Bankruptcy Code, 11 U.S.C. § 101, et seq., unless

I. FINDINGS OF FACT

In 1999, Micheal Ireland (hereafter "Micheal") co-signed the first of three notes made by Denison State Bank (hereinafter "the Bank") to Dennis Ireland (hereafter "Dennis"), his younger brother. The first note was in the amount of \$10,000. The second note, made in June of 2000, was a line of credit for \$17,500, which Micheal also co-signed. The line of credit was used, in part, to pay off the initial \$10,000 note.

Dennis owned 27 acres of rural land near Holton, Kansas. On May 22, 2001, he contracted to sell approximately 24 of those acres for \$24,000 to the Hedricks. He ultimately used a portion of the funds from that sale to pay down the line of credit from \$17,500 to \$15,000. In June 2001, Dennis asked Micheal to co-sign a third note, intending to use the money, in part, to repay the \$15,000 debt remaining due on the line of credit, and informed Michael that the third note was "for a little more" than what was still owed on the second note. Micheal initially agreed to sign the third note, but when he went to the Bank to co-sign that note, he learned for the first time that the note he was being asked to co-sign was for \$5,000 more than was remaining due on the 2000 line of credit, for a total of approximately \$20,000. He refused to co-sign the note in that amount and left the bank.

After Dennis learned that Micheal had refused to co-sign the \$20,000 note, he spoke with Micheal about it. Although portions of the content of the conversation are in dispute, both agree that a conversation took place at a family reunion. Both also agree that during the conversation, which centered around Michael's decision whether to co-sign the newest note, Micheal asked Dennis if he still owned "that land out there," which both parties understood to mean the tract of rural land near Holton. Dennis said he did, without disclosing that only a few days or weeks earlier, he had contracted to sell 24 of the 27 acres, the vast majority of that land. Micheal was unaware that the

majority of the land was being sold, which would mean that Dennis would have less collateral to use in the future to satisfy the newest loan he was being asked to co-sign. He further claims that he would not have co-signed the note if he had known that the land was sold or being sold, as he believed the land, along with other assets, such as the equity in Debtor's house, was sufficient to cover the loan in the event that Dennis defaulted.

Micheal admits that he did not specifically ask Dennis if he owned the entire 27 acres when they had this conversation, and Dennis claims that he did not intentionally mislead Micheal by not disclosing the pending sale. Dennis also claims he did not know that Michael's purpose in asking about the land was so Micheal could rely on the existence and value of that land to cover the newest loan, although admittedly the question about the land was asked in the middle of the conversation dealing with Micheal's decision whether to co-sign the newest note. Micheal ultimately cosigned the third note on approximately June 27, 2001. Just as that note was coming due the following June, 2002, Dennis defaulted on the loan and filed a petition in bankruptcy July 2, 2002. Micheal was required to pay the balance as a result of his signature on the note.

Micheal also alleges that during this same conversation, Dennis agreed that if Micheal was ultimately required to repay the loan, as a result of default by Dennis, that Dennis would repay Micheal from his share of their father's potential estate. Their father is 80 years old, alive and apparently in good health. Micheal claims that he relied on this promise in making his decision to co-sign the third note. Dennis denies making any such promise. Micheal now claims that this promise, in addition to Dennis' misrepresentation that he owned all of the 27 acres, justifies a decision excepting the debt from discharge under § 523(a)(2)(A).

Micheal also seeks a denial of discharge under § 727(a)(4). Micheal alleges that Dennis failed to include on his bankruptcy schedules one asset, an \$8,500 cash value life insurance policy,

as well as certain debts, including some bad checks, a loan from the Debtor's father and Carol Miller, a debt to his own son as a result of spending some grants or loans that his son had obtained to attend college. Michael also alleges that Dennis failed to disclose the fact that he had gambling losses. Dennis responded that some of these debts and the life insurance policy, which was exempt, were added to the schedule by amendment. The bad checks were to be taken care of outside bankruptcy, under the advice of Dennis' first counsel and other brother, Lawrence Ireland. Furthermore, Dennis testified that the loans to Dennis's father and Carol Miller were not thought to be loans, initially. This testimony was corroborated at trial by Lawrence Ireland, and never rebutted by Micheal.

The gambling losses, according to Dennis, were inadvertently omitted because he failed to closely read the question on the bankruptcy form. Dennis admittedly lost money gambling, and such losses were later disclosed in an amended schedule. Joseph Wittman, the Trustee in this case, acknowledged at trial that none of these discrepancies prejudiced his ability, as trustee, to examine Dennis' financial affairs or prejudiced Dennis' creditors.

II. JURISDICTION AND BURDEN OF PROOF

This Court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334. A proceeding to determine the dischargeability of a particular debt, and objections to discharge, are core proceedings, pursuant to 28 U.S.C. § 157(b)(2)(I) and (J), respectively. The Bankruptcy Code is intended to "provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." The "fresh start" policy

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²Grogan v. Garner, 498 U.S. 279, 286 (1991)(quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)).

embodied in the Bankruptcy Code is intended for the "honest but unfortunate debtor." To further the fresh start for honest debtors, "[e]xceptions to discharge are construed narrowly, and the burden of proving that a debt falls within a statutory exception is on the party opposing discharge." The "standard of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the ordinary preponderance-of-the-evidence standard."

III. DISCHARGE IS NOT DENIED UNDER § 727(a)(4).

Micheal claims that Dennis should be denied a discharge in this case pursuant to § 727(a)(4)(A). That statute provides, in part, that "[t]he court shall grant the debtor a discharge, unless . . . the debtor knowingly and fraudulently, in or in connection with the case . . . made a false oath or account." The primary purpose of § 727(a)(4)(A) is to ensure that dependable information is supplied to those interested in the administration of the bankruptcy estate, without the need for the trustee or other interested parties to independently investigate the true facts. The trustee and the creditors are entitled to honest and accurate "signposts on the trail" showing what property passed through the debtor's hands during the period prior to bankruptcy.

³*Id*. at 287.

⁴*Id.* at 291 (holding that preponderance of evidence standard, not clear and convincing evidence standard that is often used in non-bankruptcy fraud cases, applies to all exceptions to discharge of debts set forth in § 523).

⁵11 U.S.C. § 727(a)(4)(A).

⁶Job v. Calder (In re Calder), 93 B.R. 734, 737 (Bankr. D. Utah 1988).

 $^{^{7}}Id$.

The plaintiff has the burden to prove that the debtor knowingly and fraudulently made an oath, and that the oath related to a material fact.⁸ He must show that (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with intent to defraud; and (5) the statement related to the bankruptcy in a material way.⁹ Plaintiff must prove each one of these elements by a preponderance of the evidence.¹⁰

It is clear that a debtor's signatures, under penalty of perjury, on a bankruptcy petition, schedules of assets and liabilities, and the statement of financial affairs are written declarations that have the force and effect of oaths.¹¹ Thus, a false statement or omission within debtor's schedules may qualify as a false oath under § 727(a)(4)(A).¹² Intent may be inferred, and reckless indifference to the truth may rise to the level of fraudulent intent.¹³ Discharge will not be denied, however, when

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⁸ Fed. R. Bankr. P. 4005; *Job v. Calder (In re Calder)*, 907 F.2d 953, 955 (10th Cir.1990) (*citing* 4 Collier on Bankruptcy ¶ 727.04[1] at 727-54 to -57 (15th ed.1987)); *see also In re Brown*, 108 F.3d 1290, 1294 (10th Cir. 1997) (holding that creditor must show that debtor knowingly and fraudulently made an oath that relates to a material fact).

⁹Keeney v. Smith (In re Keeney), 227 F.3d 679, 685 (6th Cir. 2000); In re Brown, 108 F.3d at 1294.

¹⁰In re Serafini, 938 F.2d 1156 (10th Cir.1991) (holding proper standard of proof in a § 727(a)(4)(A) proceeding is proof by a preponderance of the evidence rather than by clear and convincing evidence).

¹¹See Fed. R. Bankr. P. 1008 (All petitions, lists, schedules, statements and amendments thereto shall be verified or contain an unsworn declaration as provided in 28 U.S.C. § 1746.)

 $^{^{12}6}$ Collier on Bankruptcy \P 727.04[1][c], 727-41 to 727-42 (15th rev. ed. 2001).

 $^{^{13}}$ *Id.* at ¶ 727.04[1][a], 727-40.

a false statement is due to mere mistake or inadvertence.¹⁴ Honest errors that are corrected will not ieopardize a debtor's discharge.¹⁵

Since Debtor admits that he made a few incorrect and incomplete entries on his original schedules, the crux of this dispute is whether the oaths were knowing and fraudulent and whether they related to a material fact. In other words, the Court must determine (1) whether Dennis possessed the requisite intend to defraud, and (2) whether any of the false statements or omissions were material to the bankruptcy proceeding. This Court need not reach the question of Dennis' intent, because the Court finds that none of the errors or omissions were material.

A false oath is "material," if it bears a relationship to the debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property. Although a debtor cannot excise a false oath by making subsequent corrections to his bankruptcy petition, if the estate would have no interest in the property that was omitted, then the omission should not justify a denial of discharge. However, even assets of little or no value may give rise to a denial of discharge if the omission prevents the trustee or a creditor from fully examining the debtor's pre-bankruptcy financial dealings. In addition, although failure to list a

¹⁴In re Butler, 38 B.R. 884, 889 (Bankr. D. Kan. 1984).

¹⁵In re Brown, 108 F.3d at 1294 (citing *In re Magnuson*, 113 B.R. 555, 559 (Bankr. D. N.D. 1989) (holding honest error or mere inaccuracy not proper basis for denial of discharge)).

¹⁶*In re Calder*, 907 F.2d at 955.

¹⁷Bensenville Community Center Union v. Bailey (In re Bailey), 147 B.R. 157, 165 (Bankr. N. D. Ill. 1992); 6 Collier on Bankruptcy \P 727.04[1][b], 727-40 to 727-41 (15th rev. ed. 2001).

¹⁸6 Collier on Bankruptcy ¶ 727.04[1][b], 727-40 to 727–41 (15th rev. ed. 2001).

creditor may be grounds for denying a discharge, many courts decline to so hold because such failure harms only the debtor.¹⁹

In this case, the Trustee testified that neither he, as Trustee, nor any creditor, was prejudiced by any errors or omissions on these schedules. The only asset omitted, a life insurance policy, was exempt, and, as noted above, failure to schedule creditors typically harms only the debtor, by making the unscheduled debts potentially nondischargeable. Furthermore, these errors did not prevent the Trustee from making a full inquiry into Dennis' financial affairs, and no creditor testified that Dennis' schedules prevented them from determining the Debtor's financial affairs. Debtor also amended his schedules, once the omissions were noted, to include the exempt life insurance policy, the debt to his father and to list the gambling losses.

This Court requires debtors to carefully, honestly and thoroughly complete bankruptcy schedules, and to take seriously statements made in those schedules under penalty of perjury. While this Court will not exonerate dishonest debtors who get caught, merely because they amend their schedules, it will not impose the penultimate penalty, denial of discharge, in this case, based on its particular facts.

IV. A PORTION OF THE DEBT SHOULD BE EXCEPTED FROM DISCHARGE

Section 523(a)(2)(A) of the Bankruptcy Code provides an exception to discharge if a debt was obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." The creditor must prove "(1) that debtor made a false representation; (2) that the representation was made with an intent to deceive the creditor; and (3) that the creditor, to his resulting detriment, justifiably relied on this

¹⁹*Id.* at ¶ 727.04[2], 727-43 (15th rev. ed. 2001)

representation."²⁰ The applicable law for the fraud exception, at least with respect to a contention of actual fraud, is the standard under the general common law of torts as it existed at the time of the enactment of the fraud discharge exception in § 523(a)(2)(A). Most courts look to the Restatement of Torts published shortly before Congress enacted the Bankruptcy Act in 1978 to guide the interpretation of the fraud exception.

The creditor bears the burden of proving that all elements are present.²¹ Because direct proof of intent (i.e., the debtor's state of mind) is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred. Thus, a debtor's intent to deceive a creditor in making false representations, within the meaning of the fraud discharge exception, may be inferred from the totality of circumstances, or from a knowingly made false statement.²²

Section 523 balances the competing policies of allowing an honest debtor a fresh start and preventing a deceitful debtor from prospering from his own fraud.²³ In so balancing, § 523 requires courts to strictly construe discharge provisions against the creditor, and liberally in favor of the

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²⁰Lang v. Lang (In re Lang), 293 B.R. 501, 514 (10th Cir. B.A.P. 2003); Fowler Bros. v. Young (In re Young), 91 F.3d 1367, 1373 (10th Cir. 1996).

²¹In re Lewis, 271 B.R. 877, 885 (10th Cir. B.A.P. 2002) (citing *Grogan*, 498 U.S. at 287); In re Black, 787 F.2d 503, 505 (10th Cir. 1986), abrogated on other grounds by Grogan v. Garner, 498 U.S. 279 (1991); see also In re Hoyle, 183 B.R. 635, 638 (Bankr. D. Kan. 1995).

²²*In re Young*, 91 F.3d at 1374.

²³ Field v. Mans, 157 F.3d 35, 44 (1st Cir. 1998).

debtor.²⁴ As with objections to discharge in the entirety, the burden of proof for establishing the fraud exception for a particular debt under § 523 is also by a preponderance of the evidence.²⁵

Dennis does not contest that Micheal has met his burden of showing that he has been harmed by agreeing to co-sign a note to Denison State Bank, which debt has now been discharged, making Micheal the only remaining obligor. He has been forced to honor his cosignature on the bank note, and repay Dennis' debt. However, Dennis does contest three issues: 1) did Dennis intend to defraud Micheal; 2) did Micheal justifiably rely on Dennis' statements; and if so, 3) what amount of damages were caused by that reliance.

A. Micheal proved Dennis had an intent to defraud

Intent is a factual matter to be determined under the totality of the circumstances.²⁶ Such intent may be inferred from those circumstances or from a false statement knowingly made.²⁷ Circumstantial evidence alone may suffice to establish the requisite intent.²⁸ Dennis denies any intent to deceive Micheal when he confirmed that he still did, in fact, own "that land" near Holton, during the discussion concerning whether Micheal would in fact co-sign the renewal of the note. He claims that he did not realize Michael's purpose in asking about the land, i.e., to determine whether Dennis had non-exempt assets that could be used to repay the debt in case of default. He

 $^{^{24}}$ In re Perkins, 298 B.R. 778, 787 (Bankr. D. Utah 2003) (citing In re Kaspar, 125 F.3d 1358 (10^{th} Cir. 1997)); Chevy Chase Bank v. Kukak (In re Kukak), 225 B.R. 778 (10^{th} Cir. B.A.P. 1998).

²⁵Grogan, 498 U.S. at 286–287.

²⁶*In re Young*, 91 F.3d at 1375.

 $^{^{27}}$ *Id*.

²⁸In re Liptak, 89 B.R. 3, 5 (Bankr. W.D. Pa. 1988).

thus contends that when he answered "yes" to that question, when he had in fact very recently signed a contract to sell the vast majority of the land, he did not intend to create a false impression.

A debtor's silence regarding a material fact can constitute a false representation under § 523(a)(2)(A).²⁹ A material omission is one that "creates a false impression which is known by the debtor."³⁰ When, in the context of whether Micheal would co-sign the renewed note, Micheal asked Dennis whether he still owned "that land," and Dennis failed to disclose the very recent contract to sell most of that land, that omission constituted a false representation under § 523(a)(2)(A).

First, this statement about still owning "the land" was made during a private conversation, initiated by Micheal, for the express purpose of deciding whether he would agree to co-sign the new and increased note. This conversation occurred very soon after Dennis had asked him to co-sign the note, and after Micheal had visited the Bank only to learn that he was being asked to co-sign a note \$5,000 higher than was then owed on the note. Considering the context of the conversation and the fact that Dennis had contracted to sell most of the land only a few weeks earlier, the Court does not believe Dennis' testimony that he was innocent in his failure to disclose the true facts regarding the land in question. Under these circumstances, he had a duty to disclose that fact.

This Court finds that, under these circumstances, especially the timing of the conversation coming so quickly on the heels of the sale of the land, Micheal has shown by a preponderance of the

²⁹In re Young, 91 F.3d at 1374 (holding failure to disclose the potential conflicts of interest involved in their exchange of services agreement constituted a false representation); Caspers v. VanHorne (In re VanHorne), 823 F.2d 1285 (8th Cir. 1987), abrogated on other grounds by Grogan v. Garner, 498 U.S. 279 (1991), (holding the Bankruptcy Code did not intend to protect property obtained by deceit, artifice, trick or design, a borrower has the duty to divulge all material facts to the lender, and the creditor has the right to know those facts touching upon the essence of the transaction); In re Chivers, 275 B.R. 606, 621 (Bankr. D. Utah 2002) (holding that incomplete, and thus misleading, statement can be a fraudulent representation).

³⁰*Perkins*, 298 B.R. at 787–88.

evidence that Dennis intended to mislead him by omitting the highly relevant fact that the land that Micheal was relying on, at least partly, to help repay the debt was soon to be sold. Accordingly, this omission qualifies as a false representation.

B. Micheal Ireland Justifiably Relied on Dennis' Misrepresentation

Dennis argues that Michael's reliance on this misrepresentation was not "reasonable," because Michael is a practicing attorney and he should have undertaken "customary due diligence or documentation incidental to such alleged reliance on real property." Reasonable reliance, however, is not the correct level of reliance that a creditor must demonstrate to prevail under § 523(a)(2)(A).

In 1995, in the case of *Fields v. Man*, the Supreme Court settled a split in the Circuits regarding the appropriate reliance standard for § 523(a)(2)(A) cases, holding it to be justifiable reliance, as opposed to reasonable reliance.³³ The difference, the Court noted, is while either standard requires actual reliance on the part of the challenger, "[j]ustification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct."³⁴ Justifiable reliance is, in fact, a lower standard than reasonable reliance.

³¹See Trial Brief of Defendant Dennis Ireland, Doc. No. 43, at pages 5, 6 and 8, which erroneously relies on case law using the higher "reasonable reliance" standard rather than the appropriate "justifiable reliance" standard established by the Supreme Court in *Fields v. Man*, 516 U.S. 59 (1995).

 $^{^{32}}$ *Id*. at 6.

³³Fields v. Man, 516 U.S. at 70-71.

 $^{^{34}}Id.$ at 71.

The Supreme Court in *Fields* provided one illustration from the Restatement of Torts that is particularly relevant to these facts. In that illustration, a seller claimed that the land for sale was free from encumbrances. The Court noted that "a buyer's reliance on this factual representation is justifiable, even if he could have 'walk[ed] across the street to the office of the register of deeds in the courthouse' and easily have learned of an unsatisfied mortgage." A creditor is only obligated to inspect that which would be obvious, given all of the creditor's individual abilities and knowledge, upon a cursory examination. Granted, an expert's particular knowledge or skill is a factor affecting the degree to which his cursory examination will be expected to reveal a defect, but under the facts of this case, Micheal was not required to doubt his brother's statement about the land and inquire further. Furthermore, as a matter of public policy, Dennis, who this Court finds was guilty of conscious misrepresentation, cannot offer as a defense that his brother, the plaintiff herein, failed to make an investigation or examination to verify the true facts that Dennis should have disclosed to him in the first instance.

Accordingly, the mere fact that Micheal is an attorney did not require him to conduct such a title examination before deciding to believe his brother. There is no evidence to suggest that Dennis disclosed any fact that would have put Micheal on notice that he needed to investigate further. Micheal simply inquired about Dennis' ownership of the rural land, to which Dennis answered affirmatively, without qualification.

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 $^{^{35}}$ *Id*.

 $^{^{36}}$ *Id*.

This Court also holds that a long standing friendship or close personal relationship, such as the family relationship here, weighs heavily in favor of finding justifiable reliance by Micheal.³⁷ Micheal was justified in believing that his own brother would be completely open and honest with him about this transaction, especially since the evidence showed Micheal had been helping Dennis financially over several years.

As noted earlier, actual reliance by the creditor, in addition to justifiable reliance, is required to except a debt from discharge. Micheal testified that he relied on Dennis' statement that he still owned the rural land, along with another alleged promise, when he agreed to again co-sign the note at the higher amount. Micheal clearly testified that he would not have signed the third note at the \$20,000 level if he knew the land was in the process of being sold, and would thus be unavailable to retire the debt, if Dennis defaulted. This misrepresentation was also very material to Micheal's decision, and justified his decision.

The evidence demonstrated that Dennis had just sold the 24 acres for \$24,000, more than enough to pay off the entire note Micheal was being asked to co-sign. The fact the non-exempt acreage was indeed worth more than the debt Micheal was being asked to co-sign justified Micheal's decision to co-sign the note so long as that land was available to satisfy the debt, upon Dennis' default. His testimony on this point was credible, and Dennis produced no credible evidence to the contrary. Therefore, this Court finds that Micheal has met his burden of proving actual and justifiable reliance.

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³⁷See e.g., In re Spar, 176 B.R. 321, 328 (Bankr. S.D.N.Y. 1994), (citing *In re Phillips*, 804 F.2d 930, 933 (6th Cir.1986) (reasoning that the parties had known each other 25 years and thus there was no reason for the creditor to distrust the debtor's representation) and *In re Sobel*, 37 B.R. 780 (Bankr. E.D.N.Y. 1984) (finding creditors could not be faulted if they believed that due to the personal friendship between the parties, the debtor would deal honestly with them)).

Micheal also claims that in the same conversation, Dennis promised to reimburse Micheal, if he had to pay the note, from any future inheritance he might some day receive from his father. Because this Court has already found that Micheal justifiably relied on Dennis' statement about the Holton land, when deciding to again co-sign the renewed note, the Court need not decide whether this additional promise was, in fact, made, or if made, if it would constitute a false representation under § 523(a)(2)(A).

C. Micheal was damaged by the false representation

Dennis claims that if the Court finds that the debt to Micheal, as a result of Micheal having to cover his note, is nondischargeable, that the amount of damages should not exceed the difference between the amount due on the loan prior to Michael's execution of the third note in June, 2001, which was \$15,000, and the amount due on the final note, which was \$20,000, as the misrepresentation only caused Micheal to be damaged by the difference of \$5,000. In other words, Dennis claims that because Micheal was already indebted to the bank, as a result of his June 2000 co-signature, for \$15,000, any false statement or misrepresentation that occurred in June 2001, shortly before Micheal signed for a third time, only resulted in a \$5,000 increase in liability.

Michael's only contrary argument is that Dennis should be barred from attempting to limit damages to any amount less than the entire note he had to repay, because Dennis failed to raise the issue in the final Pretrial Order. While it is true that a final pretrial order supersedes the pleadings in a case and governs the issues to be litigated at trial,³⁸ a review of the Pretrial Order in this case reveals that this issue was clearly preserved.

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³⁸ Youren v. Tintic School Dist., 343 F.3d 1296, 1304 (10th Cir. 2003).

Section 7.1(b)(1)(f) of the Pretrial Order indicates the following issues must be resolved at trial: "[I]f the answer [sic] to [subsections] a-e are all in the affirmative, *to what extent, if any*, did the debt to Plaintiff result from that reliance." (Emphasis added). The Court finds, therefore, that the Pretrial Order did preserve the proper amount of damages as an issue that had to be decided by the Court, and thus Dennis is not barred from asserting this defense.

The terms of the relevant statute provide guidance. Section 523(a)(2)(A) excepts from discharge debts "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by . . . fraud" Here, Micheal testified that he was intimately familiar with Dennis' poor financial condition even before Dennis made the misrepresentation about the Holton land. He knew Dennis had a relatively low paying job, and that his expenses were higher than his income. He knew Dennis was gambling. In fact, it was because he knew Dennis' financial situation was precarious that he questioned Dennis about the Holton land before agreeing to co-sign the June 2001 renewal note that included an additional \$5,000 over what was due at that point on the prior note.

Micheal also testified that he went to the Bank fully intending to co-sign the renewal of the loan at the \$15,000 amount, before he ever had the conversation with Dennis about the Holton land. The only reason he did not sign the \$15,000 note was because it had been raised to \$20,000 by Dennis, without Dennis telling him he was being asked to co-sign at that amount. That Dennis had not been able to retire the 2000 note, and was needing an additional \$5,000, was also evidence that Micheal was aware of Dennis' financial problems.

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³⁹11 U.S.C. § 523(a)(2)(A) (emphasis added).

It is clear to this Court that the fraudulent misrepresentation by Dennis about the Holton land only caused damages to Michael in the amount of the additional \$5,000. Michael's own testimony that Dennis was insolvent, and unable to pay his ongoing expenses even before he co-signed the third extension, buttresses the Court's conclusion that Dennis would not have likely paid anything down on the \$15,000 note executed in June 2000 before he filed bankruptcy, had Michael refused to co-sign the \$20,000 note in June 2001. If anything, it is more likely than not that Dennis' financial situation would have required him to file bankruptcy even earlier, had he not received the additional \$5,000 and the additional time to try and repay the original \$15,000.

Under the unique facts of this case, it is within the power of the Court to partially discharge the loan, that is, to divide it up into dischargeable and nondischargeable portions, based on the evidence presented at trial.⁴⁰ Language used by the Tenth Circuit Court of Appeals in *John Deere Co. v. Gerlach (In re Gerlach)*⁴¹ at first appears to prevent this result, as the Circuit noted "dischargeability is an 'all or nothing' proposition," and that a debt is either totally nondischargeable or totally dischargeable, regardless of the facts.⁴² But this Court is convinced that under the clear facts of this case, which are distinguishable from those in *Gerlach*, the Tenth Circuit would hold that only \$5,000 should be deemed nondischargeable.

In *Gerlach*, the debtor Gerlach and his son owned a John Deere dealership, the debts of which were all personally guaranteed by the debtor in 1977. When the dealership began experiencing financial difficulties in 1984, the son, who exclusively managed the business, arranged

⁴⁰See Fellows, Read, & Assocs., Inc. v. Rieder, 194 B.R. 734, 738 (Bankr. S.D. N.Y. 1996) (refusing to deem nondischarged that portion of debt for services performed prior to the misrepresentation).

⁴¹897 F.2d 1048, 1052 (10th Cir. 1990).

⁴²*Id*. at 1051.

for various parties to enter into sham purchase contracts for equipment with John Deere Company, which contracts resulted in credits that the dealership could use to pay its monthly account payments to the Company. The contracts would later be disallowed, but the immediate provisional credit, for mere receipt of the purchase contract, would buy the dealership an extra month before being deemed in default. So long as the dealership was in good standing with John Deere, because it was "current" on its monthly account payment, John Deere would and did continue to extend additional, unsecured credit to the dealership for parts orders. It was that additional, unsecured credit that was the subject of John Deere's § 523(a)(2)(A) complaint.

Although Gerlach was not involved in the day to day business, he did sign one sham purchase contract in June 1985, knowing the effect would be to buy the dealership time to make its required monthly payment while John Deere continued to make unsecured advances. Ultimately, the dealership was closed, Gelach filed bankruptcy, and John Deere filed its §523(a)(2)(A) complaint against him. The Bankruptcy and District Courts held that although debtor intentionally deceived John Deere when it entered into the sham contract, and that John Deere relied on that contract to extend provisional credit, because John Deere failed to prove it was damaged in a sum certain by the fraudulent conduct, the entire debt was deemed discharged.

On appeal, the Tenth Circuit held that the lower courts had applied an improper measure of damages, and remanded the case for a determination of the amount that the creditor could reasonably estimate was obtained by fraud. Thus, despite language that might suggest otherwise, the Tenth Circuit ultimately held that "[i]f a creditor can prove by clear and convincing evidence⁴³ that the

⁴³The Tenth Circuit, in this 1990 opinion, used the "clear and convincing evidence" standard, which was overruled the next year in favor of the "preponderance of the evidence" standard by the Supreme Court in *Grogan v. Garner*, 498 U.S. at 291.

debtor obtained credit through fraud, the court should declare the debt nondischargeable in an amount which it can reasonably estimate as obtained by the fraud.'44

In *Gerlach*, the creditor did not even suggest that the entire amount of the underlying guaranteed note, executed in 1977, years before the fraud, should be deemed nondischargeable. Instead, it merely argued that because it would have required cash on delivery for all shipped parts, or would have discontinued shipments and closed the dealership, had it known of the sham contracts, all amounts advanced after the debtor executed the sham contract should be declared nondischargeable. Our facts are thus distinguishable from those in *Gerlach*.

Here, in essence, Micheal is arguing that even amounts that he was ready and willing to guarantee—and had previously guaranteed—even before the fraudulent statement was uttered, should be deemed nondischargeable. This Court believes that despite some of the language used by the Circuit in *Gerlach*, the Tenth Circuit would not have held in that case, had it been so argued, that the entire original note to John Deere was nondischargeable because of Gerlach's subsequent fraud.⁴⁵ Thus, when the Tenth Circuit said a "debt is either totally nondischargeable or totally

⁴⁴In re Gerlach, 897 F.2d at 1052; cf. In re Audley, 268 B.R. 279, 284 (Bankr. D. Kan. 2001) (holding the statute requires a showing of damages proximately caused by the misrepresentations). See also Wingate v. Attalla (In re Attalla), 176 B.R. 650, 664 n.7 (Bankr. D. N.H. 1994) (noting that language in Gerlach is contradictory, because at one point it states that damages are an "all or nothing" proposition, but later holds debt is nondischargeable only "in an amount which [the court] can estimate can reasonably estimate as obtained by the fraud.")

⁴⁵The Tenth Circuit also relied, in part, on *Birmingham Trust Nat'l Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985), to buttress its decision in *Gerlach* that the words "to the extent obtained by fraud" added in 1984 to § 523(a)(2) did not preclude discharge only to the extent an objecting creditor could prove damages after reduction in ultimate recovery caused by forbearance. Because the Eleventh Circuit has now indicated that its *Birmingham* decision has been superseded by the changes in the 1984 statute, this Court believes the Tenth Circuit might revisit this decision. *See In re Griffith*, 206 F.3d 1389, 1394 (11th Cir. 2000) (holding *Birmingham* superseded on other grounds by Pub L. No. 98-353, 98 Stat. 333 (1984)). *Cf. Muleshoe State Bank, Muleshoe, Tex. v. Black, 77* B.R. 91, 93 (D. N.D. Tx. 1987) (distinguishing *Birmingham*, because in that case, the entire debt was

dischargeable" within the context of the *Gerlach* case, it was only speaking of the debt actually incurred as a result of the fraud, and was in fact excluding the rest of the guaranteed debt incurred well before the fraud.

This Court believes the Tenth Circuit, as a matter of public policy, was making it clear—as it should—that when it is difficult for a creditor to determine its exact damages as a result of a debtor's fraud, it is not going to place the burden on the defrauded party to precisely articulate and prove damages. Because the record in this case is unequivocal that Micheal was only induced to incur additional debt of \$5,000 as a direct and proximate result of Dennis' fraudulent conduct, the amount of nondischargeable debt will be limited to that amount. Micheal was ready and willing to co-sign the third note for \$15,000 before any false statement was uttered, and thus any loss he sustained up to \$15,000 was not caused by the fraudulent conduct.

The Court, therefore, grants judgment to Micheal Ireland, and against Dennis Ireland, in the amount of \$5,000, plus post-petition interest at the rate set forth in 28 U.S.C. § 1961.

V. DEBTOR'S COUNTERCLAIM IS DENIED

Dennis has brought a counterclaim under § 523(d), seeking to have his attorney's fees and costs paid by Micheal for bringing the §523(a)(2)(A) proceeding without merit. That subsection provides that

"If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fees for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that

fraud, noting 1984 statutory change that called *Birmingham* into question).

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created based upon the misrepresentation, whereas in *Black*, like in this case, there was no fraud with respect to the creation of the initial debt); *In re Casagrande*, 143 B.R. 893, 899 (Bankr. W.D. Mo. 1992) (holding the plain language of section 523(a)(2) limits creditor's damages to the money actually obtained by debtor by virtue of the alleged false pretenses, false representations, or actual

the court shall not award such costs and fees if special circumstances would make the award unjust.

Because the Court has found that a portion of the debt is, in fact, nondischargeable as a result of Dennis' misrepresentation regarding the Holton land, Dennis is not entitled to costs and fees. Dennis' counterclaim for costs and attorney fees is, therefore, denied.

VI. CONCLUSION

The Court finds that the Plaintiff has failed to produce sufficient evidence to support a complete denial of discharge under 11 U.S.C. § 727(a)(4), and Debtor, Dennis Ireland, is entitled to a discharge except as noted below.

This Court finds that Dennis, by his partial and misleading statement, created a duty to fully disclose to his brother, Micheal, the pending sale of the 24 acres of rural land, when Micheal was trying to decide whether to co-sign the June 2001 note. His failure to disclose that a contract was soon to close on this land caused Micheal, at least in part, to co-sign Dennis' note, on which he then defaulted, causing Micheal to incur money damages. As a result, this Court finds that Dennis obtained an extension of credit under 11 U.S.C. § 523(a)(2)(A) that he would not have obtained absent his misrepresentation. Therefore, Dennis' debt, insofar as it was proximately caused by his fraudulent misrepresentation, is excepted from discharge. The Court finds that the amount of debt induced by the fraudulent statement is \$5,000.

IT IS, THEREFORE, BY THIS COURT ORDERED that Micheal Ireland's Complaint seeking to except the debt that Dennis owes him for having to pay Dennis' debt to Denison State Bank is granted, in part, under 11 U.S.C. § 523(a)(2)(A). Micheal Ireland is granted a judgment against Dennis Ireland in the amount of \$5,000, plus post petition interest at the rate set forth in 28 U.S.C. § 1961, and this amount is nondischargeable. The remainder of the debt is dischargeable.

IT IS FURTHER ORDERED that the motion to deny discharge under 11 U.S.C. § 727(a)(4) is denied.

IT IS FURTHER ORDERED that the foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based on this ruling will be entered on a separate document as required by Fed. R. Bankr. P. 9021 and Fed. R. Civ. P. 58.

IT IS SO ORDERED this _____ day of March, 2004.

JANICE MILLER KARLIN United States Bankruptcy Judge District of Kansas

CERTIFICATE OF MAILING

	The	undersigned	certifies	that	a copy	of t	the	Memorandum	and	Order	was	deposited	in	the
United S	State	s mail, on this	S	_ day	of Ma	rch,	200	04, to the follow	ving:					

Micheal A. Ireland P.O. Box 308 Holton, Kansas 66436

Robert L. Baer COSGROVE, WEBB & OMAN 1100 Bank IV Tower 534 South Kansas Avenue Topeka, Kansas 66603 Attorney for Dennis Ireland

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The Honorable Janice Miller Karlin
Bankruptcy Judge